- ***Five deadly business sins***
  by Peter Drucker
  - **Introduction**
    - The past few years have seen the downfall of one once dominant business after another: General Motors, Sears, and IBM, to name just a few.
    - But in every case the main cause has been at least one of the five deadly business sins avoidable mistakes that will harm the mightiest business.
  - **The five sins**
    - ***1 Worship of high profit margins and of "premium pricing."***
      - The first and easily the most common sin is the worship of high profit margins and of "premium pricing."
      - Examples
        - The prime example of what this leads to is the near-collapse of Xerox in the 1970s.
        - GM's troubles-and those of the entire US. automobile industry-are, in large measure, also the result of the fixation on profit margin.
      - The lesson: The worship of premium pricing always creates a market for the competitor.
      - And high profit margins do not equal maximum profits.
        - Total profit is profit margin multiplied by turnover.
        - Maximum profit is thus obtained by the profit margin that yields the largest total profit flow, and that is usually the profit margin that produces optimum market standing.
    - ***2 Mispricing a new product by charging "what the market will bear."***
      - Closely related to this first sin is the second one: mispricing a new product by charging "what the market will bear."
      - This, too, creates risk-free opportunity for the competition.
      - It is the wrong policy even if the product has patent protection.
      - Given enough incentive, a potential competitor will find a way around the strongest patent.
      - Examples
        - Fax machines
        - Nylon
    - ***3 Cost-driven pricing***

- The third deadly sin is cost-driven pricing.
- The only thing that works is price-driven costing.
- Most American and practically all European companies arrive at their prices by adding up costs and then putting a profit margin on top.
- And then, as soon as they have introduced the product, they have to start cutting the price, have to redesign the product at enormous expense, have to take losses-and, often, have to drop a perfectly good product because it is priced incorrectly.
- Their argument?
- "We have to recover our costs and make a profit."
- This is true but irrelevant: customers do not see it as their job to ensure manufacturers a profit.
- The only sound way to price is to start out with what the market is willing to pay—and thus, it must be assumed, what the competition will charge—and design to that price specification.
- Examples
    - Consumer electronics
    - Machine tools
    - Automobiles
- To be sure, to start out with price and then whittle down costs is more work initially.
- But in the end it is much less work than to start out wrong and then spend loss-making years bringing costs into line-let alone far cheaper than losing a market.

- ***4 Slaughtering tomorrow's opportunity on the altar of yesterday.***
    - The fourth of the deadly business sins is slaughtering tomorrow's opportunity on the altar of yesterday.
    - Example
        - It is what derailed IBM.
            - IBM & PCs vs. mainframe
            - IBM & computers vs. punch cards
        - The second time providence did not come to IBM's rescue, however.
- ***5 Feeding problems and starving opportunities.***
    - The last of the deadly sins is feeding problems and starving opportunities.
    - For many years I have been asking new clients to tell me who their best-performing people are.

    - And then I ask: "What are they assigned to?"
        - Almost without exception, the performers are assigned to problems—to the old business that is sinking faster than had been forecast; to the old product that is being outflanked by a competitor's new offering; to the old technology—for example, analog switches, when the market has already switched to digital.
    - Then I ask: "And who takes care of the opportunities?"
        - Almost invariably, the opportunities are left to fend for themselves.
  - All one can get by "problem solving" is damage containment.
  - Only opportunities produce results and growth.
  - And opportunities are actually every bit as difficult and demanding as problems are.
  - First draw up a list of the opportunities facing the business and make sure that each is adequately staffed (and adequately supported).
  - Only then should you draw up a list of the problems and worry about staffing them.
  - I suspect that Sears has been doing the opposite starving the opportunities and feeding the problems-in its retail business these past few years.
  - This is also, I suspect, what is being done by the major European companies that have steadily been losing ground on the world market (e.g., Siemens in Germany).
  - The right thing to do has been demonstrated by GE, with its policy to get rid of all businesses even profitable ones —that do not offer long-range growth and the opportunity for the company to be number one or number two worldwide.
  - And then GE places its best performing people in the opportunity businesses, and pushes and pushes.
- **Wrap up**
  - Everything I have been saying in this article has been known for generations.
  - Everything has been amply proved by decades of experience.
  - There is thus no excuse for managements to indulge in the five deadly sins.
  - They are temptations that must be resisted.

- [1993]